Supreme Court, U.S.
FILED
AUG 27 1992
OFFICE OF THE CLERK

No. 91-212

IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

BARCLAYS BANK PLC,
Petitioner,

v.

FRANCHISE TAX BOARD,
AN AGENCY OF THE STATE OF CALIFORNIA,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of the State of California

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BRIEF OF THE GOVERNMENT OF THE UNITED KINGDOM AS AMICUS CURIAE SUPPORTING PETITIONER

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WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF AMICUS CURIAE	1
SUMMARY OF ARGUMENT	2
ARGUMENT	4
I. RESPONDENT'S USE OF WORLDWIDE COMBINED REPORTING IS OF GRAVE CONCERN TO THE UNITED KINGDOM	4
II. WHEN A STATE SEEKS TO TAX FOREIGN COMMERCE, THE FOREIGN COMMERCE CLAUSE OF ARTICLE I, SECTION 8, CLAUSE 3 OF THE CONSTITUTION OF THE UNITED STATES REQUIRES EXTENSIVE CONSTITUTIONAL SCRUTINY	7
III. THIS APPEAL CONTAINS ALL THE ELEMENTS THIS COURT HAS DETERMINED AS NECESSARY TO DETERMINE THE QUESTION ON WHICH IT HAS PREVIOUSLY RESERVED OPINION: THE CONSTITUTIONALITY OF RESPONDENT'S APPLICATION OF WORLDWIDE COMBINED REPORTING TO DOMESTIC CORPORATIONS WITH FOREIGN PARENTS AND FOREIGN CORPORATIONS WITH EITHER FOREIGN PARENTS OR FOREIGN SUBSIDIARIES	8
CONCLUSION	10
APPENDIX	1a

TABLE OF AUTHORITIES

Cases	Page
Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983)	3, 4, 6-9
Kraft General Foods, Inc., Petitioner v. Iowa Department of Revenue and Finance, 60 LW 4583, 4584 (6-16-92)	7
Japan Lines, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979)	6-7
Constitution, Statutes and Treaties	
Constitution of the United States, Foreign Commerce Clause of Article I, Section 8, clause 3	3, 7
Section 812-815 of the United Kingdom Income and Corporation Taxes Act 1988	9
1975 Income Tax Convention With the United Kingdom of Great Britain, and Northern Ireland, December 31, 1975, T.I.A.S. No. 9682	4
Other Authorities	
12 July 1983 Letter of United Kingdom Chancellor of the Exchequer Nigel Lawson to Secretary of the Treasury of the United States Donald T. Regan	5
22 June and 8 December 1991 Letters from United Kingdom Chancellor of the Exchequer Norman Lamont to Secretary of the Treasury of the United States Nicholas F. Brady	5
Demarche No. 83 from the United Kingdom Embassy, 18 May 1982	5
Demarche No. 211 from the United Kingdom, President European Communities, on behalf of the Member States of the European Communities, 30 October 1981	5
House of Commons Official Report, *Parliamentary Debates* (Hansard), 1036 (9 July 1984)	9
January 30, 1986 Letter from United States Secretary of State George P. Shultz to the Governor of California	9

TABLE OF AUTHORITIES—Continued

Page

March 5, 1986 Letter of United States Secretary of the Treasury James A. Baker, III to Representative Daniel Rostenkowski, Chairman of the House of Representatives Committee on Ways and Means 9

Note No. 51 from United Kingdom Embassy to the United States Department of State, 3 March 1980 5

Note No. 91 from the United Kingdom to the United States Department of State, 22 July 1992 5

November 8, 1985 Statement of President Ronald Reagan, 45 *Weekly Compilation of Presidential Documents* 1368 9

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INTEREST OF AMICUS CURIAE

The issue before this Court is the constitutionality of Respondent Franchise Tax Board's application of worldwide combined reporting ("WWCR") to Barclays Bank of California ("BARCAL"), a domestic corporation with a United Kingdom parent, and Barclays Bank International, Limited ("BBI"), a United Kingdom corporation with a United Kingdom parent and foreign subsidiaries. BARCAL and BBI are members of but one of the many United Kingdom based corporate groups adversely affected by Respondent's isolated insistence upon the use of WWCR.

The United Kingdom and the United States have long subscribed to an international tax policy including the globally accepted arm's length separate accounting ("AL/SA") standard for allocating profits of multinational corporations between nations. Respondent's use of WWCR, in contradiction to the established international tax policy, has disrupted, and continues to disrupt, trading and investment relations between the two countries.

The Government of the United Kingdom ("the United Kingdom") and the United States Federal Government have traditionally cooperated to discuss and resolve matters of mutual concern generally, and tax matters specifically. The decision of the Supreme Court of the State of California below places in question future negotiations between the United Kingdom and the United States.

The United Kingdom hereby submits this brief *amicus curiae* in support of Petitioner.[1]

SUMMARY OF ARGUMENT

Respondent's application of WWCR to BARCAL and BBI, and other members of United Kingdom based multicorporate groups, is of grave concern to the United Kingdom. Such application is contradictory to the international tax policy established by the United Kingdom, the United States, and their trading partners. The use of WWCR subjects corporations like BARCAL and BBI to double taxation and disrupts trade between the United Kingdom and the United States. Respondent applies WWCR to income earned outside the United States without any provision for taxes assessed in the jurisdiction in which the income was earned.

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[1] Petitioner is successor in interest to Barclays Bank International, Limited and has assumed the interest of Barclays Bank of California for present tax matters and claims for refund.

Petitioner and Respondent have consented to the filing of this brief *amicus curiae* in letters filed with the Clerk of this Court.

The United Kingdom cannot negotiate with California to avoid the extraterritorial results of WWCR. The United Kingdom must communicate with the United States Federal Government. The lower court decision places in doubt the power and authority of the Federal Government to participate in future discussion and resolution of treaty difficulties.

Respondent's use of WWCR results in California taxing foreign commerce. This Court has recognized that such taxation implicates matters of concern to the entire United States and has held that the Constitution of the United States, Foreign Commerce Clause of Article I, Section 8, clause 3, requires extensive constitutional scrutiny of such taxation.

This appeal presents an issue upon which this Court has previously reserved opinion: the constitutionality of Respondent's application of WWCR to a domestic corporation with a foreign parent, and a foreign parent with either a foreign parent or foreign subsidiaries. In its decision in which determination of that question was reserved,[2] this Court indicated a number of significant factors not presented by the application of WWCR to a domestic parent corporation with foreign subsidiaries.

All of those factors are present here: (1) WWCR is being applied to a foreign entity and its subsidiary; (2) such application is a matter of international, rather than domestic concern; (3) the Solicitor General of the United States has filed *amicus curiae* briefs in support of BARCAL and BBI at every court level; (4) the United States Federal Government has made clear its tax policy for domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, is AL/SA and that tax policy is threatened

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[2] *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983).

by Respondent's use of WWCR; (5) the trading partners of the United States are offended; and (6) the United Kingdom has enacted retaliatory legislation.

ARGUMENT

I. RESPONDENT'S USE OF WORLDWIDE COMBINED REPORTING IS OF GRAVE CONCERN TO THE UNITED KINGDOM.

The United Kingdom, the United States, and their trading partners avoid double taxation of their corporate citizens through the use of AL/SA. The requirement for AL/SA has been contained in every tax treaty to which the United Kingdom, the United States, and their trading partners, have been, or are now, a party.[3] Under AL/SA, corporations are subject to tax solely by the jurisdiction in which they operate and only on that portion of their income attributable to the business carried on in that jurisdiction. Profits are subsequently taxable when distributed as dividends in those jurisdictions where the dividends are received for tax purposes.

Under AL/SA, the income of each member of a corporate group is computed by separate accounting on the basis that each member of the group must deal with other members as if they were wholly separate entities owned by unrelated interests. Profitable corporations are subject to tax where the profits are made, and the less profitable or unprofitable subsidiaries pay less or no tax in the jurisdictions where they conduct business.

This Court has recognized that WWCR is a "serious divergence" from the internationally accepted AL/SA.[4]

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[3] For example: 1975 Income Tax Convention With the United Kingdom of Great Britain, and Northern Ireland, December 31, 1975, T.I.A.S. No. 9682.

[4] *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 187 (1983).

In fact, no nation and no other nation's local political subdivisions use WWCR. Using WWCR, Respondent rejects the international corporate taxation principles of AL/SA and treats separate corporations—foreign and domestic—that are part of a multi-corporate group as one, and subjects all the worldwide income of the international corporate group to tax as one "unitary" corporation. It apportions the group's combined income between California and the rest of the world on the basis of an arbitrary formula composed of the ratio of payroll, sales, and property of the combined corporate group in California compared to the world. Moreover, Respondent combines the income without regard to whether such income is taxable under the Internal Revenue Code or applicable treaty, and without regard to the fact that income has been attributed to and taxed in foreign jurisdictions, under long-standing and well-recognized procedures established in international law. The United Kingdom has repeatedly objected to the extra-territorial results of WWCR.[5] The text of the most recent demarche, Note No. 91 from the United Kingdom to the United States Department of State, 22 July 1992, is contained in the appendix to this brief.

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[5] For example: Note No. 51 from United Kingdom Embassy to the United States Department of State, 3 March 1980; Demarche No. 211 from the United Kingdom, President European Communities, on behalf of the Member States of the European Communities, 30 October 1981; Demarche No. 83 from the United Kingdom Embassy, 18 May 1982; 12 July 1983 Letter of United Kingdom Chancellor of the Exchequer Nigel Lawson to Secretary of the Treasury of the United States Donald T. Regan; 22 June and 8 December 1991 Letters from United Kingdom Chancellor of the Exchequer Norman Lamont to Secretary of the Treasury of the United States Nicholas F. Brady; Note No. 91 from the United Kingdom to the United States Department of State, 22 July 1992. The United Kingdom has also participated in the numerous official expressions of opposition to Respondent's use of WCR submitted by demarche to the United States by the Member States of the European Communities from 19 March 1980 through 22 July 1992.

Respondent's insistence on its right to apply an isolated method of income allocation to BARCAL and BBI, contrary to the internationally accepted standard, is equal to a claim that California has the status of a nation in the international tax area and that the international community would accept a single nation having a contradictory system of income allocation. Neither can be the case. As this Court made clear in *Japan Air Lines, Ltd. v. County of Los Angeles*:

> California, by its unilateral act, cannot be permitted to place these impediments before the Nation's conduct of its foreign relations and its foreign trade.[6]

Additionally, as this Court has recognized, California is in no position to negotiate with the United Kingdom or other foreign governments, and neither the tax treaties nor federal law provides a mechanism by which the United States Federal Government could negotiate double taxation arising out of state tax systems.[7]

The United Kingdom, and other trading partners of the United States, must rely on the power and authority of the United States Executive Branch to speak for the nation. The lower court decision calls into question that power and authority. It would establish the principle that unless and until the United States Congress acts to limit a taxing state, it is free to tax as it pleases. The United Kingdom and the United States cannot continue their efforts to harmonize tax systems and manage the difficult problems of double taxation under such principle.

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[6] 441 U.S. 434, 453 (1979).

[7] *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 193 (1983).

II. WHEN A STATE SEEKS TO TAX FOREIGN COMMERCE, THE FOREIGN COMMERCE CLAUSE OF ARTICLE I, SECTION 8, CLAUSE 3 OF THE CONSTITUTION OF THE UNITED STATES REQUIRES EXTENSIVE CONSTITUTIONAL SCRUTINY.

This Court has acknowledged that WWRC is a "serious divergence" from AL/SA, the method adopted by foreign taxing authorities "consistent with accepted international practice." *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 187 (1983). It has also recognized that if a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate and such retaliation of necessity would be directed not just at the taxing state, but the United States.[8] Thus, the constitutional prohibition against state taxation of foreign commerce is broader than the protection afforded to interstate business within the United States and requires additional scrutiny by this Court. *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 445-446 (1979); *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 185 (1983); *Kraft General Foods, Inc., Petitioner v. Iowa Department of Revenue and Finance*, 60 LW 4583, 4584 (6-16-92).

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[8] *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 450 (1979) citing *Chy Lung v. Freeman*, 92 U.S. 275, 279, 23 L.Ed. 550 (1876) (invalidating California's bond requirement for Chinese immigrants):

> "[I]f this plaintiff and her twenty companions had been subjects of the Queen of Great Britain, can any one doubt that this matter would have been the subject of international inquiry? Upon whom would such a claim be made? Not upon the State of California; for, by our Constitution, she can hold no exterior relations with other nations. It would be made upon the government of the United States. If that government should get into difficulty which would lead to war, or to suspension of intercourse, would California alone suffer, or all the nation?"

III. THIS APPEAL CONTAINS ALL THE ELEMENTS THIS COURT HAS DETERMINED AS NECESSARY TO DETERMINE THE QUESTION ON WHICH IT HAS PREVIOUSLY RESERVED OPINION: THE CONSTITUTIONALITY OF RESPONDENT'S APPLICATION OF WORLDWIDE COMBINED REPORTING TO DOMESTIC CORPORATIONS WITH FOREIGN PARENTS AND FOREIGN CORPORATIONS WITH EITHER FOREIGN PARENTS OR FOREIGN SUBSIDIARIES.

Container involved Respondent's application of WWCR to a domestic parent corporation with overseas subsidiaries. The determination of the issue presented by Petitioner's petition, the constitutionality of WWCR when applied to domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, was reserved.[9]

This appeal, as opposed to *Container*, involves a domestic corporation with a foreign parent, and a foreign parent with a foreign parent and subsidiaries. Here, there is: (1) an "automatic asymmetry" between Respondent's use of WWCR and the acknowledged international tax structure; (2) the tax is imposed on a foreign entity and its subsidiary; and (3) it is a matter of international concern because the United Kingdom and other nations are interested in insuring equitable taxation of their corporations.

The serious threat to the foreign policy of the United States posed by Respondent's use of WWCR is supported by factors also not present in *Container*. Here the Solicitor General has filed amicus curiae briefs at every court level in support of BARCAL and BBI that make clear the Federal Government's view that WWCR threatens the United States' foreign policy and there can be no question that the taxation policy of the United States for domestic corporations with foreign parents,

[9] 463 U.S. 159, 188 n. 26, 196 n. 32 (1983).

or foreign corporations with either foreign parents or foreign subsidiaries, is AL/SA.[10]

The most obvious foreign policy implication a state tax can have is to offend the United States' trading partners and lead them to retaliate.[11] Proof of that implication is also present here. All of the major trading partners of the United States have repeatedly expressed their offense at Respondent's application of WWCR to multi-corporate groups to their corporate citizens.[12] The United Kingdom, after patiently awaiting the cessation of that use for over a decade, has enacted retaliatory legislation. Section 54 of and Schedule 13 to the Finance Act of 1985 (now reenacted as Section 812-815 of the Income and Corporations Taxes Act 1988) gives the United Kingdom the authority to retaliate by depriving American parent corporations, with a presence in states that use WWCR, of the shareholders' tax credit which the United Kingdom gives on dividends paid by their subsidiaries in the United Kingdom.[13]

Petitioner's petition brings to this Court an issue upon which it previously reserved its opinion—the significance of domestic corporations with foreign parents, or foreign

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[10] See for example: November 8, 1985 Statement of President Ronald Reagan, 45 *Weekly Compilation of Presidential Documents* 1368; January 30, 1986 Letter from United States Secretary of State George P. Shultz to the Governor of California; and March 5, 1986 Letter of United States Secretary of the Treasury James A. Baker, III to Representative Daniel Rostenkowski, Chairman of the House of Representatives Committee on Ways and Means.

[11] *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 194 (1983).

[12] See for example: Brief of the Member States of the European Communities and the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland as *amicus curiae* supporting Petitioners filed herein.

[13] House of Commons Official Report, *Parliamentary Debates* (Hansard), 1036 (9 July 1985) (statement of John Moore).

corporations with either foreign parents or foreign subsidiaries, in assessing the unconstitutionality of Respondent's use of WWCR. The United Kingdom believes this Court would not have left the issue unresolved in *Container*, if it had any doubt that domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, present additional considerations deserving extensive constitutional scrutiny. The United Kingdom is anxious to have the issue resolved before more harm is done to United Kingdom corporations and to United Kingdom-United States relations.

CONCLUSION

For these reasons, Petitioner's petition should be granted.

Respectfully submitted,

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Dated: August 27, 1992

APPENDIX

NOTE NO.: 91

The British Embassy present their compliments to the Department of State and have the honour to refer to the decision of the California Supreme Court in the case of *Barclays Bank v. California Franchise Tax Board.* The Embassy wish to convey their disappointment with the decision of the Californian Supreme Court to uphold the State of California's imposition of the worldwide unitary basis of taxation. In the Embassy's view, there are important matters not fully taken into account by the California Supreme Court and immediate review of the decision by the U.S. Supreme Court is essential.

The Embassy further have the honour to note that the California Supreme Court did not refer to the paramount interests of both the United States and British governments and those other governments which comprise the major trading partners of the United States in maintaining the internationally accepted arm's length separate entity standard for allocating profits of multinational corporations between nations. The worldwide unitary basis of taxation imposed by California is contrary to and incompatible with those standards. California's use of this method interferes with the joint efforts of our joint efforts of Britain and the United States to harmonize tax systems and to manage the difficult problems of double taxation.

The Embassy are further concerned that the California Supreme Court considers that the United States Congress has adopted a policy permitting the application of the unitary basis of taxation by the states of the United States to foreign-owned multinational corporations; that the British Government and the United States Government had agreed to that policy choice by entering into the US/UK Double Taxation Treaty with a reservation

to a provision in that Treaty barring such use, and that the British Parliament was acceding to the "demands" of the United States Congress in ratifying the Treaty.

A majority of the United States Senate (though not a two-thirds majority) favoured inclusion of a provision barring use of such taxation method in the Treaty. It is difficult to see how a policy favouring use of such method could arise from a reservation leaving this issue unaddressed. The British Government and the British Parliament have not accepted the State of California's use of the unitary method, a point which has been made clear in a number of communications, notably in letters dated 22 June and 8 December 1991 from the British Chancellor of the Exchequer, the Rt Hon Norman Lamont MP, to the U.S. Secretary of the Treasury. The Financial Secretary to the Treasury told the House of Commons on 14 May 1992 that the retaliatory legislation enacted in the United Kingdom in 1985 is "not a mere ornament on the statute book". There have been repeated assurances by members of Congress that the problem would be solved.

The California Supreme Court's characterisation of the United States Government's opposition as mere "Executive Branch aspirations" and its further statement that the U.S. Government has expressed an "eloquent silence" on worldwide unitary taxation belittles the extensive discussions between the British and the United States governments on the impropriety of that taxation method. The implications of these pronouncements by the California Court for future discussions and resolutions of treaty difficulties are a matter of great concern. The British Government understood that the assurances of the Executive Branch were the assurances of the Government of the United States and could therefore be relied upon. The California Supreme Court appears to call into question the capacity of the US Executive, led by the President, to deal with the British Government by imply-

ing that Congress is the only branch of U.S. Government capable of setting policy in this area.

In the 1991 joint study by the United States Department of Treasury and the British Inland Revenue it was agreed that the best means of achieving resolution of this matter was in the Supreme Court of the United States. Accordingly, it is essential that the United States Solicitor General should support the Barclays petition for certiorari before the United States Supreme Court and continue its amicus curiae support. The British Government believes immediate review of the California Supreme Court decision is essential to avoid an outcome that could risk damaging relations between the United States and the United Kingdom.

The British Embassy avail themselves of this opportunity to renew to the Department of State the assurances of their highest consideration.

[British Embassy Seal]

British Embassy
Washington D.C.

22 July 1992